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IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

EX PARTE THE EQUITABLE TRUST COMPANY OF NEW YORK—ORIGINAL NO. 169.

IN THE MATTER OF THE PETITION OF THE EQUITABLE TRUST COMPANY OF NEW YORK, AS TRUSTEE, FOR A WRIT OF MANDAMUS—ORIGINAL NO. 2757.

IN THE MATTER OF THE APPEAL OF THE EQUITABLE TRUST COMPANY FROM THE ORDER ISSUING THE INJUNCTION, DATED FEBRUARY 21, 1916.

REPLY TO BRIEF OF SAVINGS UNION BANK AND TRUST COMPANY.

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Filed this.....day of March, 1916.

F. D. MONCKTON, Clerk.

By....., Deputy.

THE JAMES H. BARRY CO.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

Ex parte The Equitable Trust Company of New York, Original No. 169.

In the Matter of the Petition of The Equitable Trust Company of New York, as Trustee, for a Writ of Mandamus, Original No. 2757.

In the Matter of the Appeal of The Equitable Trust Company from the Order Issuing the Injunction, dated February 21, 1916.

REPLY TO BRIEF OF SAVINGS UNION BANK AND TRUST COMPANY.

In the briefs heretofore filed but incidental attention has been paid to the petition for intervention of the Savings Union Bank and Trust Company. On March 27th a brief was filed in support of that petition, and as the statements contained in this brief might lead to confusion, we will reply thereto by stating the facts shown by the record.

At the time the motion for entry of decree was made in the lower court, no petition for intervention had been presented by the Savings Union. On the afternoon of March 6th, the hearing of the motion for decree having been continued from morning till afternoon, the Savings Union asked leave to intervene for the sole purpose of being heard on the question of the *up-set price*. The Savings Union asked that an up-set price of $40,000,000 should be fixed. This petition was never heard, and on March 13th a petition for intervention, accompanied by a bill in all respects similar to that presented with the petition for intervention filed here, was presented in the lower court. Time to answer this petition filed in the lower court has not as yet expired.

On the hearing of the proceedings on mandamus and prohibition a petition for intervention was filed in this Court.

As the questions presented to this Court related to the validity of the proceedings in the lower court taken at a time prior to the presentation of such petition, it is apparent that the petition has no legal relevancy to the proceedings pending in this Court. It is in fact a mere attempt to afford a basis on which orders made before its presentation may rest, an attempt to create a record justifying judicial action after that action had taken place. This, of course, cannot be done, but were it otherwise, the petition for intervention does not afford such a basis. The claim of the intervenor is:

(a) That the obligation of the Denver Company to make the payments of interest and sinking fund required by Contract B is secured by an equitable charge on the properties of the Denver Company.

(b) That this equitable charge is prior to the liens created by the Adjustment and Refunding Mortgages of the Denver Company.

(c) That three Banking houses in New York, each of whom has a representative on the Reorganization Committee, are interested in the Adjustment and Refunding bonds of the Denver Road, and do not desire to see these bonds declared subordinate to the equitable charge arising from Contract B.

(d) That it is the intention of the Reorganization Committee to deprive the non-assenting bondholders of their rights under Contract B.

(e) That the Bankers interested in the Adjustment and Refunding bonds dominate the Reorganization Committee and the Trustee.

For these reasons the intervenor asks leave to intervene, in the foreclosure suit and therein to sue the Denver Company and the trustees of the Adjustment and Refunding bonds, to foreclose the equitable charge created by Contract B, and establish its priority over the Adjustment and Refunding Mortgages.

The verification of the Complaint in Intervention is in the following form:

United States of America,
Northern District of California—ss.

JOHN S. DRUM, being duly sworn, deposes and says: That he is an officer, to wit, the President, of SAVINGS UNION BANK AND TRUST COMPANY, the intervenor named in the foregoing complaint of intervention, and knows the contents thereof; that he is credibly informed with respect to the truth of all of the facts set forth in said complaint and believes the same to be true.

JOHN S. DRUM.

Such a verification is wholly insufficient as an affidavit, and affords no proof of the charges made.

Clark v. *Nat. Linseed Oil Co.*, 105 Fed., 792.

But even if the bill were properly verified, the record in the case shows that the charges of fraud are made in willful disregard of the facts disclosed by the record.

CONTRACT B.

The entire complaint in intervention is based on the theory that Contract B creates an equitable charge on the properties of the Denver Company, superior to the Adjustment and Refunding Mortgages.

Even if this claim be not well founded still the Reorganization Committee and the Trustee intend to assert this very claim against the Denver Company, but do not intend to press any litigation involving this claim to decree, until after foreclosure of the

Mortgage on the properties of the Western Pacific.

Does this difference in point of view as to the time at which this claim is to be asserted form any basis for inferring fraud, or permitting intervention in the foreclosure suit, even if such inference be indulged?

As under the proposed Plan of Reorganization not one dollar of money or property goes to any person other than the holder of a First Mortgage bond, and as indebtedness of $55,000,000 subordinate to the lien of the First Mortgage is wiped out and accorded no recognition, though the Denver Company is the person to whom this debt is owed, there is no room for any charge of fraud connected with the pending proceeding. Accordingly, the right of intervention is claimed on account of a fraud which the intervenor is credibly informed the Trustee intends to perpetrate hereafter in a different proceeding.

Obviously the intervention is sought in the wrong proceeding.

But apart from this the entire claim is founded upon a distortion of facts.

THE QUESTION OF EQUITABLE CHARGE.

As stated in the petitioner's brief, the right to realize upon the property mortgaged cannot be suspended because the interest on the mortgage may be guaranteed, and the guaranty of the interest may be secured by an equitable charge. As, however, so much has been said upon the question of the equitable charge,

and as inferences of fraud are drawn from the fact that proceedings to realize upon the guaranty of interest have been delayed, we will state in some detail the actual facts and considerations which moved the Reorganization Committee to delay proceedings under Contract B till after foreclosure and sale of the properties of the Western Pacific.

In a contract entered into between the Denver & Rio Grande Railroads and the Western Pacific Railway on the 22nd day of June, 1905, the Denver Companies agreed to enter into three contracts with the Western Pacific. One was Contract A. The covenant in the agreement of June 22nd, pursuant to which Contract A was executed, provided that under Contract A the Denver Companies should agree to purchase Second Mortgage bonds of the Western Pacific in such amount as might be required, after the application of the proceeds of the First Mortgage bonds, to complete the acquisition, construction and equipment of the main line of the Western Pacific Company from Salt Lake City to San Francisco, with adequate terminals and other property necessary for use in connection with said main line.

The second was Contract B. This agreement has been much discussed, and the covenant contained in the contract of June 22, 1905, pursuant to which Contract B was executed, provided that under Contract B the Denver Company should loan to the Western Pacific Company, upon its unsecured prom-

issory notes, moneys sufficient, after application of the proper available income of the Western Pacific Company, to provide operating expenses, taxes and interest on its First Mortgage and sinking fund. This provision also require that Contract B should obligate the Denver Company to pay directly to the Trustee moneys sufficient to pay interest and sinking fund.

Pursuant to this contract of June 22, 1905, Contracts A and B were executed, these contracts being executed on the same day, to wit, June 23, 1905.

By Contract A the Denver Company obligated itself to purchase Second Mortgage bonds of the Western Pacific Company to such extent as might be necessary to complete the Western Pacific, after there had been applied to construction the proceeds of the First Mortgage issue. It was clearly contemplated by this contract that the Denver Company might be called upon to lay out $18,750,000 in this manner. As an actual matter of fact, the Denver Company was called upon to lay out, in the completion of the construction of the Western Pacific, approximately $33,000,000.

On the same day Contract B was executed. The following facts should be noted:

1. Contract B was never recorded.

2. Contract B did not purport to create a legal charge upon the property of the Denver Company, or a mortgage on the income of the Denver Company.

It did purport to provide against alienation by the Denver Company of its properties under any circumstances, unless the purchaser acquiring the properties of the Denver Company on such alienation taking place should assume the burdens and obligations of Contract B.

No question has arisen, or can ever arise, concerning the liability of the Denver Company under Contract B, but the very moment that it is asserted that Contract B creates a charge prior to the Adjustment and Refunding Mortgages of the Denver Company, controversies of the most bitter character immediately arise. Whatever the result of such controversies may be, it will be contended, that inasmuch as the Denver Company, then owing $80,000,000, undertook on the same day on which it entered into Contract B to supply the funds necessary to complete the Western Pacific, clearly it could not have been intended that Contract B should create a charge upon the properties of the Denver Company which would prevent that road from raising by mortgage the moneys essential to the performance of Contract A.

Again, it will be contended that the reference to Contract B contained in the Adjustment and Refunding Mortgages are not sufficient to put the purchasers of bonds on notice that Contract B actually created an equitable charge. Again, questions will arise concerning the validity of the provision declaring that the Contract should run with the respective railways, for only certain types of covenant run with the land,

and it has not yet been determined that covenants of the class herein mentioned fall within the character of covenants which may lawfully run with the land.

It is obvious that questions of this class, involving millions of dollars, could not be finally adjudicated with rapidity, nor would any decree be accepted as final short of that of the Supreme Court of the United States.

The only action that could be brought under Contract B prior to the foreclosure and sale of the assets of the Western Pacific was an action by the Trustee to recover the interest then accrued. If such action were brought and the judgment paid, a new action would have to be brought for the next instalment, and if this procedure were followed, the Western Pacific Railroad would stay in possession of the Receivers for all eternity, and the Trustee would merely continue to sue upon the guaranty for payment of interest. As, however, the Denver Company owes between $123,000,000 and $124,000,000, and as its income was not sufficient to pay the interest on its own debt and the interest on the First Mortgage of the Western Pacific, and as a bond issue of the Denver Company in the principal amount of $10,000,000 was in default, though the default did not arise from the failure to pay interest, it would, in the opinion of any reasonable man, be perfectly obvious that a decree against the Denver Company, whether that

decree established Contract B as a charge prior to the Adjustment and Refunding bonds, or as a charge subsequent to those bonds, could result in nothing but receivership of the Denver Company. It is also quite obvious to any one knowing the condition of the Denver Company that such receivership would stop the payment of interest on bond issues of the Denver Company prior to that of the Refunding Mortgages.

Under these circumstances, the only sensible course to pursue was to foreclose the Western Pacific mortgage and proceed against the Denver Company, not merely for the specific performance of its contract to pay interest, *but for a judgment in a capital sum equal to the damage sustained by the Western Pacific bondholders through the breach of the obligation of the Denver Company to pay interest. Such a judgment could only be obtained after the Western Pacific properties had been sold on foreclosure, and the amount of the deficiency ascertained.* If, after the rendition of such a judgment, the Denver Company went into receivership, this jugdment, which it was estimated would amount to between $20,000,000 and $30,000,000, would become one of the principal claims against the Denver Company, if prior to the Refunding bonds that priority could be established. If subsequent to the Adjustment and Refunding bonds, still it came ahead of all of the stock of the road,

and was a claim of large amount and real value, provided there existed in the hands of the holder sufficient funds to protect the claim on reorganization. Such funds were provided by the Reorganization Plan of the Western Pacific road through the underwriting of bonds to be issued by the new corporation.

We respectfully submit that it cannot honestly be said that the failure to assert the claim against the Denver Company on Contract B, and to reduce that claim to judgment prior to foreclosure and decree, is fraud. On the contrary, any other procedure would be willful and deliberate sacrifice of the rights of the holders of bonds of the Western Pacific Company under the guaranty contained in Contract B. Yet, such is the claim of fraud upon which the petition for intervention is filed.

The obvious propriety of the course adopted of itself completely refutes the charges of fraud, which are made either in complete ignorance, or through malice.

The claim that the Plan of Reorganization contemplates depriving non-assenting bondholders of their rights under Contract B is absurd. The holder of a single bond has the right to insist that an action be brought to enforce that Contract. The provision of the Plan restricting the right of benefit to those joining therein refers only to benefits derived under the

Plan, and does not purport to destroy the right of non-assenting bondholders.

Respectfully submitted.

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